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BEFORE THE ARIZONA CORPORATION COMMISSION

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Arizona Corporation Commission
DOCKETED
JUL 22 2013
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IN THE MATTER OF THE APPLICATION OF SANDARIO WATER COMPANY, INC. FOR APPROVAL OF A RATE INCREASE

IN THE MATTER OF THE APPLICATION OF SANDARIO WATER COMPANY, INC. FOR AUTHORITY TO INCUR LONG-TERM DEBT.

DOCKET NO. W-01831A-12-0392
DOCKET NO. W-01831A-12-0467

SURREPLY TO THE REVISED STAFF REPORT

Pursuant to the Procedural Order dated May 1, 2013, the Sandario Water Company ("Company" or "Applicant") hereby files its Surreply to the Revised Staff Report.

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1. Income Tax Recovery

As previously noted, the Commission adopted the policy providing "a tax pass-through entity should be allowed to recover income tax expense as part of its cost of service and that its revenue requirement should be grossed up for the effect of income taxes". *See* Docket No. W-00000C-06-0149, Decision No. 73739 at Attachment 1, p. 2 (Feb. 21, 2013). The Commission further directed "[t]his new policy will be applied in pending and future rate cases." *Id.*

Yet Staff still refuses to allow Sandario to recover the tax expense and creates strawman arguments to justifying their position. First, Staff argues that the Company should have used the lower tax rate of the test year, not the 2013 tax rate. The Company disagrees with Staff's position because the 2013 tax rate is known and measurable. The Company also notes that Staff routinely requires utilities to adjust property taxes to the lower rates and not use the test year rates.

Staff's second argument is that the Company did not "allow for the potential pass-through of taxes" from the Trust. (Emphasis added). Staff further develops this argument to assert it cannot calculate the tax recovery because it did not know the tax rates of the Trust beneficiaries.

The Company notes that the Trust is a taxable entity, nevertheless to put this issue to rest the Company notes that Buck Lewis is the only Trust beneficiary, and his taxable state and federal tax rate is a cumulative 28%.[1] But pursuant to the Commission policy, the Company calculated the income tax allowance based upon the lower C-Corporation tax of rate 24.67% because that is the lowest rate. Thus, the Company's calculation provided in its Response to the Revised Staff Report is correct regardless of whether Mr. Lewis or the Trust pays the tax.

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[1] The Company is willing to allow Staff to review documents to establish Mr. Lewis' taxable rates, but the documents will not be allowed to become public.

Therefore, the revenue requirement should be increased by $16,891.37 to allow for recovery of income tax expense. Sandario further requests that the requisite $4.25 per month simply be added to the monthly minimum.

2. Loan Authorization Amount

The Company has requested authorization for a loan not to exceed $633,450 to design and construct a 100,000 gallon storage tank and upgrade substandard electrical equipment at Well Site 3. After reading Staff's response, the Company believes that its estimates are more reasonable.

Staff continues to estimate the project cost at $587,650, which is $45,800 less than the Company's estimate. Staff arrives at its estimated cost using a different method, so it is difficult to compare line items. However, the most striking difference relates to engineering. Staff estimates engineering will cost no more than $10,000. This estimate is far too low. Further, Staff ignores the Company's point regarding Davis-Bacon wages required by WIFA. This requirement causes the hourly rates for electricians and boilermakers skyrocket to approximately $35.00 and $52.00 per hour, respectively. This is why the Court should recommend that the Commission authorize the Company to enter into a WIFA loan not to exceed $633,450.

3. Recovery of Debt Service Reserve

The Company's position is straightforward: Money WIFA requires for loan payment should be collected through a surcharge and paid to WIFA. This includes principal, interest, and debt service reserve (DSR). The DSR should be a component of the WIFA surcharge because it is held and controlled by WIFA for the benefit of WIFA.

In other rate cases, Staff has consistently disagreed with the fact it now asserts; namely, WIFA holds the DSR in case of default and then uses it to close the loan early. *See* Staff's Revised Response at p. 2. Rather than continuing to argue that the Company should pay the DSR because it is a Company "savings account", now Staff is arguing that the DSR is a "double counting" of the principal and interest payment and the customers should not have to pay it.

The Company shares Staff's dislike for the DSR as required by WIFA. But the fact is that the DSR protects WIFA, not the Company, as Staff now recognizes. The Company would support any Staff effort to have this provision changed in the WIFA loan documents. Nevertheless, there is no rationale for making the Company pay the DSR because it does not benefit the Company – it benefits WIFA.

Staff's only other argument is that the Company can pay the DSR because there is enough cash flow to do so. But this argument misses the point. Before the loan was proposed, Staff's position was that the Company required $34,847 of cash flow per year. After the loan was proposed, Staff essentially reduced the requisite cash flow to $25,955, which reflects a reduction of $8,892 that will be used to pay the DSR. In other words, Staff's position is that if it takes the loan, the Company somehow needs less cash flow.

Reducing the Company's cash flow by 25% is crippling. The Company should not have its needed cash flow reduced simply because it needs a loan to make major system repairs and improvements. Therefore, the Court should either: (1) include the DSR as part of the WIFA Surcharge; or (2) increase the Company's revenue requirement by $8,892 to pay it.

4. CIAC Mismatch

Staff agrees with the Company that there is a mismatch. Essentially Staff is arguing the mismatch is acceptable, however, because it is benefitting the customers in lower current rates. But the end result is that the Company will have an artificially low rate base. In the long run, this is detrimental to the customers because the Company's rate base will be so artificially low that there will be no reason for the Company to invest in the system. Simply stated, the rate base is on the verge of becoming so low that any investment will be a waste of money. This position makes no sense if Staff wants the owners to invest in the water company.

5. BMPs

In its Response, the Company pointed out the BMPs are costly to establish and implement. The Company maintains its position. Staff does not dispute the Company's position, it simply states that the Company can ask to recover its BMP costs in the next rate case. While this is true, it is also true that its request for cost recovery can be rejected. Staff has identified no reason why BMPs are necessary in this case, and the Company opposes any additional cost, whether it is paid by the Company or the customers, without a reason. Therefore, the Company opposes any BMPs.

6. Approval of Construction Deadline

The Company appreciates Staff's willingness to extend the Approval of Construction filing deadline to 30 months after the Commission renders a final decision is this matter.

RESPECTFULLY SUBMITTED this 22nd day of July.

MOYES SELLERS & HENDRICKS LTD.

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Original and 13 copies filed
this 22nd day of July 2013, with:

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